

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 6965

BILL NUMBER: SB 207

DATE PREPARED: Feb 26, 2001

BILL AMENDED: Feb 26, 2001

SUBJECT: Inheritance Tax.

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FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: (Amended) This bill completely exempts from the Inheritance Tax property interests transferred to lineal descendants and ancestors (Class A transferees) with respect to persons who die after June 30, 2001. The bill changes the status of a transferee who is a spouse, widow, or widower of a child of a transferor from a Class B to a Class A transferee for purposes of the Inheritance Tax.

Effective Date: July 1, 2001.

Explanation of State Expenditures: (Revised) The bill could potentially result in reductions in the amount of resident Inheritance Tax revenue retained by the counties. The revenue loss to counties is estimated to be approximately \$4.45 M statewide. As a result of the revenue loss, the bill could potentially increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The impact on the state General Fund may not equal the revenue loss to the counties since most are retaining more revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in the table below assumes that the revenue loss to the counties will be fully reimbursed by the state. In addition, since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the impact that the bill may have on county replacement would be somewhat delayed. The section on Local Revenues contains further explanation of the replacement procedure.

Explanation of State Revenues: (Revised) The bill could potentially reduce revenue from the Inheritance Tax and increase revenue from the Estate Tax. The bill could potentially reduce Inheritance Tax revenue by an estimated \$51.6 M in FY 2003. The bill could also increase Estate Tax revenue by an estimated \$45.3 M in FY 2003. The net impact of the bill on state revenue is estimated to be a reduction of \$5.9 M beginning in FY 2003. Further, the impact of state expenditures on county replacement increases the loss to the state (net revenue loss plus county replacement expenditures) to approximately \$10.3 M in FY 2003.

| STATE IMPACT | FY 2003 |
|---|----------------|
| Inheritance Tax Revenues | (\$51,537,000) |
| Estate Tax Revenues | \$45,688,000 |
| State Expenditures for County Replacement | (\$4,450,000) |
| Net Increase (Decrease) | (\$10,299,000) |

Background on Inheritance Tax: The bill would completely exempt transfers to Class A transferees from the Inheritance Tax. The bill would change the status for a transferee who is a spouse, widow, or widower of a child of a transferor from Class B to Class A. The change from Class B to Class A would change the Inheritance Tax exemption for transfers to this group from \$500 to a complete exemption. Both changes made by the bill would be with respect to transfers made by persons who die on or after July 1, 2001. Since the Inheritance Tax does not have to be paid until a maximum of 18 months after the decedent's death (within 12 months of the date of death to receive the 5% early payment discount), the full impact of the bill likely would not be experienced until FY 2003.

The estimated impact of the Inheritance Tax changes is based on an Office of Fiscal and Management Analysis (OFMA) database consisting of Inheritance Tax returns relating to a decedent who died between July 1, 1997, and June 30, 2000. The database consists of 112,951 transferee records. It is assumed that the sample is representative of the universe of persons paying the Inheritance Tax. Of the total tax liability for the sample, 39.43% is attributable to Class A transferees, 35.35% is attributable to Class B transferees, and 25.22% is attributable to Class C transferees.

Also, approximately 0.99% of the taxes paid in this sample were attributable to transferees who were the spouse, widow, or widower of a child of the transferor.

The estimated revenue loss from the changes is based on the State Budget Agency FY 2003 forecast for the Inheritance Tax equal to \$150 M. This total includes revenue from the Estate Tax estimated to be approximately 15% based on FY 2000 collections. This suggests that Inheritance Tax revenue is forecast at \$127.5 M. The estimated tax liability attributable to Class A transferees is, therefore, approximately \$50.3 M. The estimated tax liability attributable to transferees who were the spouse, widow, or widower of a child of the transferor is approximately \$1.26 M.

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for Class A transferees and for the spouse, widow, or widower of a child of the transferor could potentially have an impact on Indiana Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the federal state death tax credit (against the federal Estate Tax) exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an OFMA database of Estate Tax returns relating to a decedent who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. It is assumed that the sample is representative of the universe of estates paying the Indiana Estate Tax. Approximately 77% of the transferees comprising these estates were Class A transferees and roughly 93% of the Inheritance Tax liability for the sample was paid

by the Class A transferees. Also, roughly 3.8% of the sample was comprised of transferees who were either a spouse, widow, or widower of a child of the transferor. The change in the exemption for Class A transferees led to a 201% increase in the Estate Tax liability of the sample. Based on the FY 2003 revenue forecast and FY 2000 collections, Estate Tax revenue is estimated to be \$22.5 M. As a result, the revenue gain from the bill is estimated to be approximately \$45.3.

The change in status of transferees who are either a spouse, widow, or widower of a child of the transferor led to a 1.75% increase in the Estate Tax liability of the sample. Based on the FY 2003 revenue forecast and FY 2000 collections, Estate Tax revenue is estimated to be \$22.5 M. As a result, the revenue gain from the bill is estimated to be approximately \$394,000.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised) Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The revenue loss to counties is estimated to be approximately \$4.45 M statewide. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. Therefore, a reduction in tax retained by a county due to the bill would be reimbursed only to the extent that the changes made by the bill cause the amount of tax revenue retained by the county to fall below its guaranteed amount. Currently, most counties are retaining more Inheritance Tax revenue than is guaranteed under the replacement procedure.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, December 19, 2000.
Bill Reynolds, Indiana Department of State Revenue, 232-2075.
OFMA Inheritance and Estate Tax Databases.